Supreme Court, U.S.
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No. 96-1268

In The

Supreme Court of the United States

October Term, 1996

THE CITY AND COUNTY OF DENVER, COLORADO,

Petitioner,

v.

BONNIE SONNENFELD, individually and on behalf of all those similarly situated, KARL NICOLETTI, on behalf of himself and all others similarly situated, HILDA EBLING STOLLER TRUST, by Hilda Stoller a/k/a Hilda Stoller Milstein, Trustee, and LARRY RABINOWITZ, on behalf of himself and all others similarly situated,

Respondents.

On Petition For Writ Of Certiorari To The United States Court Of Appeals For The Tenth Circuit

PETITIONER'S REPLY BRIEF

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I. CERTIORARI REVIEW IS WARRANTED NOTWITHSTANDING THE INTERLOCUTORY NATURE OF THE TENTH CIRCUIT'S DECISION.

The question which Denver presents for review was decided by the Tenth Circuit on interlocutory appeal. That fact does not "militate against the exercise of certiorari jurisdiction," as Respondents contend (Brief in Opposition ("Brief") at 1).

Respondents cite a 1916 case, *Hamilton-Brown Shoe Co. v. Wolf Bros. & Co.*, 240 U.S. 251 (1916), in support of their contention. However, in *Hamilton*, this Court simply held that its denial of certiorari after an interlocutory appeal did not preclude it from reviewing issues that arose during the interlocutory proceedings when it granted certiorari after a second appeal. *Id.* at 257-58. More recently, this Court has made it clear that the interlocutory nature of an appeal does not warrant denial of certiorari where the question presented is otherwise appropriate for review. *See Fed. Power Comm'n v. Transcont'l Gas Pipe Line Corp.*, 423 U.S. 326, 330-31 (1976) ("We agree with the Commission that the challenged order, although interlocutory in nature, is properly reviewable by this Court pursuant to 28 U.S.C. § 1254(1)"); *Nixon v. Fitzgerald*, 457 U.S. 731, 742-43 (1982); *Coleman v. Paccar, Inc.*, 424 U.S. 1301, 1304 (1976) (per Rehnquist, J., as Circuit Justice); *see also Air Line Pilots Ass'n, Int'l v. UAL Corp.*, 897 F.2d 1394, 1397 (7th Cir. 1990) ("A litigant in a federal case is not compelled to wait until the case is over before seeking certiorari, because it is not a requirement of certiorari to review an order of a federal court that the order be a final decision"). Indeed, in at least one of the cases relied on by Respondents in their brief, *J.I. Case Co.*

v. Borak, 377 U.S. 426, 428 (1964), the securities law issue on which certiorari was granted had been decided by the court of appeals on interlocutory appeal.

In *Nixon*, concerns of judicial economy warranted immediate review where the question presented was a pure issue of law as to which the court of appeals had made a binding decision. 457 U.S. at 743 n.23. In *Fed. Power Comm'n*, the Court found it appropriate to review an interlocutory order because "any review by this Court of the propriety of the order must be immediate to be meaningful." 423 U.S. at 331. The same considerations warrant immediate review of the issue in this case as well. Whether there is an implied private right of action under the securities laws against municipal issuers is a pure question of law, and has been definitively decided by the Tenth Circuit. Resolution of the issue requires no additional factual development in the lower courts. Although Respondents' class action against Denver and other parties is proceeding, nothing in the ongoing litigation will have any bearing on the issue presented for review.

The Tenth Circuit's decision means that Denver must now mount a defense in what promises to be protracted and expensive securities fraud class action suits. Denver should not be required to defend, go through a trial on the merits and pursue a further appeal if – as it believes – Respondents had no right of action against it from the outset. There is no basis for deferring review of the question presented here simply because it was decided by the Tenth Circuit on interlocutory appeal.

II. WHETHER THERE IS AN IMPLIED PRIVATE RIGHT OF ACTION UNDER FEDERAL SECURITIES LAWS AGAINST MUNICIPAL ISSUERS IS AN UNSETTLED QUESTION THAT SHOULD BE DECIDED BY THIS COURT.

Certiorari review is warranted when a court of appeals has decided an important question of federal law that has not been, but should be, settled by this Court. Sup. Ct. R. 10(c). Contrary to Respondents' assertions, the issue presented here is just such a question.

Respondents state that the Tenth Circuit's decision is in accord with the "vast majority" of district courts and commentators (Brief at 5); that the decision is consistent with the precedents of this Court and with the position of the SEC (*id.* at 13); and that there is "great unanimity of opinion on this issue" (*id.*). Not so.

Neither this Court nor any federal appeals court except the Tenth Circuit has addressed the issue raised in Denver's petition. As evidenced by the authorities cited by each side in this case, the commentators are split; as recently as 1995, a leading treatise stated that "the extent of liability of municipal issuers under the federal securities laws is far from settled." Marc I. Steinberg, *Securities Regulation: Liabilities and Remedies* (1995), § 13.05, at 13-20. Respondents' "vast majority" of district courts consists of exactly two cases – neither of which can serve as a basis for upholding the Tenth Circuit's decision.[1]

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[1] The first of these, *In re Wash. Pub. Power Supply Systems Sec. Litigation*, 623 F. Supp. 1466 (W.D. Wash. 1985), *aff'd*, 823 F.2d 1349 (9th Cir. 1987), ignored legislative history and simply hypothesized that the language of the 1975 amendment defining

As for the SEC, Respondents are correct in stating that that agency has "long taken the position that the securities laws' antifraud provisions apply to municipalities" (Brief at 13 n.7). However, this is not the same as taking a position on the question whether municipal issuers are subject to *private damages actions* for alleged violations of the securities laws. As to that issue, no less an authority than former SEC Chairman Roderick M. Hills stated during Senate hearings on the Municipal Securities Full Disclosure Act of 1976 that he "was certain of the SEC's authority to act under the securities acts against fraud in municipal securities transactions, but he

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"person" to include governments "appears to expand" the class of persons liable for fraudulent practices to include municipalities, and that in expanding the definition of person, Congress "must have intended" that governments were to be treated the same as other persons under the Act except where specifically exempted. *Id.* at 1479. It is evident from this language that the court was simply making an assumption without any support for such assumption in the case law or in the legislative history. Further, as noted in Denver's petition, the Ninth Circuit's decision on the appeal of this case casts doubt on the district court's resolution of the municipal issuer liability issue. *See* Petition at 8 n.3. In *In re CitiSource, Inc. Sec. Litigation*, 694 F. Supp. 1069 (S.D.N.Y. 1988), the primary issue was not whether New York City was subject to liability as an issuer, but whether it could be held liable for alleged misrepresentations made by its employees that led to the decline in value of CitiSource stock. *Id.* at 1072-73. In answering this question in the affirmative, the court acknowledged that the principal concern of Congress in 1975 was not with municipal issuers, but with professionals trading in the municipal securities market, and added: "Congress took pains to make explicit that it did not intend by the 1975 amendments to regulate municipalities *qua* issuers." *Id.* at 1074 n.8.

was uncertain as to whether a municipal securities investor could bring a private suit under the securities acts." Thomas J. Schwarz, *Municipal Bonds and the Securities Laws: Do Investors Have an Implied Private Remedy?*, 7 Sec. Reg. L. J. 119, 153-54 (1979), *citing* Hearings on S. 2574 and S. 2969 before the Subcomm. on Securities of the Senate Comm. on Banking, Housing & Urban Affairs, 94th Cong., 2d Sess. 22 (1976).

In sum, the issue on which Denver seeks review is far from "settled," as Respondents contend. The Tenth Circuit attempted to resolve the issue, but its analysis is flawed and its result is wrong. The issue needs to be decided by this Court.

III. LEGISLATIVE HISTORY CANNOT BE IGNORED, OR CITED ONLY SELECTIVELY, IN DECIDING THE QUESTION PRESENTED HERE.

In regard to the role of legislative history in resolving the issue presented for review, Respondents' position appears to be that legislative history is irrelevant – unless something can be found in that history that would support the Tenth Circuit's conclusion.[2] Denver believes legislative history is not only relevant, but in fact must be

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[2] Respondents first argue that recent decisions of this Court cast doubt on the value of legislative history as an interpretive device (Brief at 7); they then "submit that this Court has provided more than enough 'guidance' on the uses of legislative history as an interpretive tool" (*id.* at 9); and they finally conclude that it "is unnecessary to resort to legislative history in this case" (*id.* at 9-10). In the next breath, Respondents launch into a discussion of legislative history relied on by the Tenth Circuit which, in their view, demonstrates that Congress

considered in order to decide whether Congress intended that there should be a private right of action against municipal issuers.

This issue cannot be resolved simply by looking at "clear statutory language" (Brief at 9). In the first place, there is no language whatever in any federal securities statute that affords a private right of action for alleged violations of the antifraud provisions. Moreover, Respondents' reliance on *Central Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A.*, 511 U.S. 164, 114 S. Ct. 1439, 128 L.Ed.2d 119 (1994), for this proposition is misplaced. In *Central Bank*, the Court's concern was not with whether a private right of action existed, but with determining the scope of conduct prohibited by Section 10(b). The Court carefully distinguished the inquiries required to resolve the two issues. When the issue is the scope of conduct prohibited by Section 10(b), "the text of the statute controls our decision." 128 L.Ed.2d at 129. However, when the issue relates to the elements of a private liability scheme, a court must infer how Congress would have addressed the issue, since "Congress did not create a private § 10(b) cause of action and had no occasion to provide guidance about the elements of a private liability scheme." *Id.*

"clearly intended that municipal securities would remain subject to the antifraud provisions." *Id.* at 10. If anything, Respondents' analysis illustrates the truth of the statement that using legislative history to interpret statutory language is "like looking over a crowd and picking out your friends" (*see* Petition at 17), and supports Denver's argument that this Court needs to provide guidance as to how legislative history should be used to ascertain congressional intent.

IV. THERE WAS NO JUDICIAL RECOGNITION OF A PRIVATE RIGHT OF ACTION UNDER THE SECURITIES LAWS AGAINST MUNICIPALITIES PRIOR TO 1975.

The Tenth Circuit found that the lack of discussion of a private right of action against municipalities in the legislative history of the 1975 securities amendments was "not necessarily anomalous." In the court's view, Congress may have intended the 1975 amendments as a clarification of existing law because there was "some authority suggesting municipalities could be subject to the well-established private cause of action under § 10(b)." Petition at App. 9. Denver pointed out in its petition that this explanation was unsupportable, since the one case cited by the Tenth Circuit (*Baron v. Shields*, 131 F. Supp. 370 (S.D.N.Y. 1954)) did not even address the issue.

Respondents assert that "several other pre-1975 federal securities cases similarly recognized a Section 10(b) private right of action against municipal defendants." Brief at 8 n.2. This statement is misleading at best. The "several other cases" cited by Respondents are simply other rulings by the same district court in cases brought by various bond purchasers against a bridge commission in Nebraska and its members. As in *Baron* (which is cited in all these rulings), there is nothing in any of these cases to indicate that the issue of the availability of a private right of action against municipal issuers was even raised, let alone decided.

V. INFERRING A PRIVATE RIGHT OF ACTION AGAINST MUNICIPAL ISSUERS IS UNNECESSARY FOR THE PROTECTION OF INVESTORS AND IS CONTRARY TO PUBLIC POLICY.

Although they claim that the issue raised by Denver is not important enough to be reviewed by this Court, Respondents assert at the same time that any result other than the one reached by the Tenth Circuit would have a "devastating impact" on the municipal securities market. Brief at 13-14. In support of this statement, Respondents refer to assorted municipal bond fiascoes in New York, Washington and California,[3] and cite expressions of concern from various sources about the effect of a holding that the antifraud statutes do not "apply to" municipal issuers. *Id.* at 16 and 16 n.10. However, whatever the merits of these concerns, they say nothing about the issue raised here – namely, whether there is an *implied private right of action* against municipal issuers under the securities laws. As explained in Denver's petition, the securities laws can "apply to" municipal issuers, in the sense of subjecting them to SEC enforcement actions for violations of antifraud provisions, *without* subjecting municipalities to private damages liability under Section 10(b) and Rule 10b-5.

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[3] In contrast to the situations described by Respondents, there has never been a default on the Denver bonds. Moreover, Respondents' own authority commented, after discussing the effect of municipal bond defaults in New York, Washington, and Orange County, that: "A Rule 10b-5 suit cannot correct these municipal securities market disasters." Ann Judith Gellis, *Municipal Securities Market: Same Problems – No Solutions*, 21 Del. J. Corp. L. 427, 469 (1996).

Respondents also assert that "there is no reason to believe that the SEC has sufficient resources or incentives to effectively police the municipal securities industry" (*id.* at 16), and cite a law review article in support of that statement. However, the same article notes that since the appointment of Arthur Levitt as Chairman of the SEC,

> the SEC has, both directly and indirectly, advocated for major regulation of the municipal securities market. It has also focused its enforcement energies on cleaning up the market. It has conducted a record number of investigations against municipal securities dealers. Within days of the news of Orange County's debacle in December 1994, the SEC began an investigation to see if there were any violations of the antifraud provisions of the federal securities laws. In March 1995, the SEC created, for the first time, a division specifically devoted to issues of municipal finance, the Office of Municipal Finance.

Gellis, supra, 21 Del. J. Corp. L. at 429.

There is no basis for inferring a private right of action against municipal issuers based on the perception that existing mechanisms are inadequate, or that failure to do so will somehow mean that municipal issuers will no longer need to be concerned about the adequacy of their bond disclosures. Municipal issuers are subject to certain regulation by the SEC, which is empowered in appropriate cases to order restitution for municipal securities investors. *See Schwarz*, 7 Sec. Reg. L. J. at 154. In addition, municipal securities investors may have remedies against issuers under state law, and may bring private actions against underwriters, brokers and dealers in municipal securities under the federal securities laws as well.

As Denver pointed out in its petition, not only is implication of a private right of action against municipal issuers unnecessary, but it will also have serious effects on the ability of municipalities to use bonds to fund their capital needs. Respondents attempt to downplay this concern by suggesting that the widely recognized abuses that accompany private securities fraud actions have somehow been "eliminated" by Congress's enactment of the Private Securities Litigation Reform Act of 1995, Pub. L. No. 104-67, 109 Stat. 737 (1995) (Brief at 15). While it is to be hoped that this legislation will alleviate some of the most burdensome aspects of defending a securities fraud class action, it is unlikely to eliminate meritless 10b-5 actions. Under the Tenth Circuit's opinion, municipal issuers such as Denver can be sued in private damages litigation, and will still have to defend themselves. There is no reason to impose on them the financial hardship that such a defense will entail even under the 1995 Reform Act, when doing so is both unnecessary to protect investors and contrary to the intent of Congress.

Respectfully submitted,

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